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Glossary

ADR  Average Daily Rate
RevPAR  Revenue per Available Room
GDP  Gross Domestic Product
MICE  Meetings, incentives, conferencing, and exhibitions
Korean Wave  Popularity of Korean entertainment and culture outside Korea, starting in the 1990s
FAR  Floor Area Ratio
Officetel  Hybrid of "office" and "hotel" in Korea; refers to a multi-purpose building with units that can be used both as office or residential space
CAGR  Compounded Annual Growth Rate
KTO  Korea Tourism Organization
KHA  Korea Hotel Association
KMCST  Korean Ministry of Culture, Sports and Tourism
KRW  Korean Won

Remarks

In this report, we have used information about those hotels registered as tourist hotels and controlled by the KMCST under the "Korean Tourism Promotion Law".
Instead of Seoul tourism statistics, Korean tourism statistics are used in the inbound business analysis due to the lack of information available for the Seoul market, which is visited by approximately 80% of international visitors to Korea, according to the KTO.
Market Summary

Seoul, the capital of South Korea, is one of the most active hotel development markets in Asia. Against a backdrop of strong demand growth and limited room supply in the recent years, there has been a recent increase in hotel development in the capital. The Seoul Metropolitan Government reports that approximately 77 new hotel projects have been submitted that could potentially add around 14,776 rooms by 2015. Given the current lack of construction finance in the country, it is unlikely that all these projects will materialise and some may also be delayed. KTO forecasts that more than 10 million international tourists will visit Korea in 2012 in a trend that is expected to continue until 2015, with an increase of one million visitors each year. The trend should sustain Seoul's strong hotel market performance in the short term which is heavily dominated (approximately 80%) by international visitors to Korea.

The centre of Korea's political, economic and financial sectors for more than 600 years, Seoul has capitalised on its rich heritage, traditions and natural tourism resources to strengthen its profile as a major leisure destination in Asia by offering tourists a diverse mix of cultural, entertainment, dining and shopping experiences.

The number of international visitors to South Korea has grown significantly over the past decade. In addition to the depreciation of the KRW and the increased popularity of the Korean Wave, more visitors from mainland China as a result of visa deregulation and the Korean government's tourism initiatives have made Seoul more attractive as a tourism destination compared to other cities in Asia.

We have also witnessed solid growth in the performance of Seoul's hotel sector over the past few years in terms of both occupancy rates and ADR. It has been noted that this is due mainly to a shortage of hotel rooms in the market and an increase in demand.

We expect demand among potential visitors to Seoul to remain strong, due mainly to the ongoing popularity of the Korean Wave and rising demand from mainland China, which will ensure that the Seoul hotel market continues to perform strongly, despite the new hotel supply that will be added to the market over the coming years. Healthy investment returns and easier development/conversion options available under the government’s incentive policies are expected to diversify the hotel investment landscape in Seoul and make the market even more active.

Economic Snapshot

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012F</th>
<th>2013F</th>
<th>2014F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (%)</td>
<td>6.3</td>
<td>3.6</td>
<td>2.2</td>
<td>2.1</td>
<td>3.4</td>
</tr>
<tr>
<td>Nominal GDP (USD billion)</td>
<td>1,015</td>
<td>1,116</td>
<td>1,115</td>
<td>1,236</td>
<td>1,405</td>
</tr>
<tr>
<td>Consumer Price Index (%)</td>
<td>2.9</td>
<td>4.0</td>
<td>2.0</td>
<td>1.9</td>
<td>2.9</td>
</tr>
<tr>
<td>Policy Interest Rate (%)</td>
<td>2.50</td>
<td>3.25</td>
<td>2.75</td>
<td>3.00</td>
<td>3.75</td>
</tr>
<tr>
<td>Avg. Exchange Rates (KRW per USD)</td>
<td>1,135</td>
<td>1,153</td>
<td>1,111</td>
<td>1,005</td>
<td>980</td>
</tr>
<tr>
<td>Avg. Unemployment Rate (%)</td>
<td>3.7</td>
<td>3.4</td>
<td>3.4</td>
<td>3.9</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Source: Global Insight (forecast as at 25 October 2012)
Major Business Districts

There are three major business districts in Seoul, namely the Seoul Central Business District (Seoul CBD), the Gangnam Business District (the GBD) and the Yoido Business District (the YBD). As these areas attract business clientele with accommodation needs, the city’s main hotel markets are formed in and around these districts. Each district can be characterised as below:

**Seoul CBD**
Located in Jung-gu and Jongno-gu Districts, north of the Han-gang River, the Seoul CBD has been the heart of the country’s political and economic scene since the 14th century. Most commercial and investment banks, embassies, conglomerates’ headquarters and Korean branches of foreign companies are located in this area. In addition, the historical architecture, museums, commercial districts and Namsan Mountain attract leisure visitors to this area. Major hotels in the Seoul CBD include such full-service properties as The Westin Chosun Seoul, the Lotte Hotel Seoul, The Plaza Hotel Seoul and The Shilla Seoul, as well as such limited-service hotels as the Ibis Seoul Myeongdong, the Sky Park hotel portfolio, and the Ramada Hotel and Suites Seoul Namdaemun. The Seoul CBD is also the hottest area for recent hotel development projects, with about 40 hotels planned to be added in Jung-gu and Jongno-gu Districts, as well as in Dongdaemun-gu District, which is adjacent to the Seoul CBD.

**GBD**
Located in Gangnam-gu and Seocho-gu Districts, south of the Han-gang River, the GBD is the newest of the city’s three business districts, although it already plays a critical role in Korea’s economy. Companies from the IT, private banking, venture capital funds, chemical, health and pharmaceuticals, and defence industry sectors are located in this area. In addition to office complexes, such as COEX, as well as along Teheran Road, the main road leading to corporate and government offices, and commercial buildings in the area. Major hotels in the GBD include such full-service properties as Park Hyatt Seoul, the InterContinental Seoul COEX, The Ritz Carlton Seoul and the Lotte Hotel World, along with such limited-service hotels as the Ibis Seoul Ambassador and the Bestwestern Premier Gangnam. In the GBD area, about 15 hotels are planned to be added over the coming years.

**YBD**
Yoido Island in Yongdeungpo-gu District, located south-west of the Han-gang River and also recognised as the YBD, is Korea’s finance hub, home to the Korean Stock Exchange and domestic securities companies, as well as the National Assembly and major media companies. Due to high land prices and its easy accessibility to the Seoul CBD, the YBD has yet to see its hotel market take shape. In addition, accommodation demand in the YBD has generally been absorbed by the Seoul CBD, which offers more entertainment and leisure attractions, or other adjacent sub-markets with reasonable ADRs. The major accommodation property in the YBD is the Marriott Executive Apartments Seoul, which opened in 2006. In recent years, however, there has been an emerging trend of hotels being included in redevelopment projects in new sub-markets near the YBD, such as Mapo, Yongdeungpo and Guro. With a limited number of hotels in the area, and an expected increase in both leisure and corporate traffic, these sub-markets are expected to continue to develop. Major hotels in these sub-markets include the Lotte City Hotel Mapo, the Courtyard Seoul Times Square and the Sheraton Seoul D-Cube City Hotel. Taking advantage of the recent FAR incentive for hotel development offered by the government, new mixed-use complexes in the YBD started to include hotels as a part of their properties, such as the Conrad Seoul in the Seoul International Finance Center.
Tourism Market Overview

In 2011, Seoul’s tourism and accommodation market benefited from increased demand from Asian countries. The earthquake that hit the eastern part of Japan on 11 March 2011 (the 3-11 earthquake) resulted in an immediate drop in both leisure and business visitors from Japan, Korea’s number one tourism market, although demand began to recover from June 2011 up to June 2012 and had exceeded more than 10% of the figure for the same period in the previous year. The 3-11 earthquake in Japan and the flood in Thailand in 2011 had a positive impact on the Korea tourism market by encouraging Asian tourists to choose Seoul/Korea as an alternative destination.

International Visitor Arrivals
The total number of international visitors to Korea has shown a healthy growth over the past 10 years and has reached approximately 9.8 million in 2011, an 11.3% increase over the previous year and almost double 2002 result. The only exception of this trend was 2003, the year after 2002 FIFA World Cup Korea/Japan and the Busan Asian Games 2002, and when global tourism was affected negatively by the Iraq war and the Severe Acute Respiratory Syndrome (SARS) epidemic.

The y-t-d - September figure for visitor arrivals increased by 18.9% in 2012 compared to the same period in 2011.

The increase in the number of international visitor arrivals to Korea in recent years can be attributed to several factors, including the increase in the popularity and influence of the Korean Wave in other Asian countries, improved visa regulations for mainland Chinese tourists, which started in August 2010, and the favourable exchange rate of the KRW to other major currencies, as well as recent economic growth in other Asian countries and the Korean government’s ongoing tourism promotions.

The Korean government designated 2010-12 as “Visit Korea Years” in a bid to achieve 10 million visitors by 2012. Major events and festivals were planned over these three years, among them the G-20 Summit in 2010, the Formula One Korean Grand Prix from 2010 and Expo 2012 Yeosu.

Tourism receipts have also grown significantly since 2005, due not only to the increase in demand for inbound tourism to the country, but also because of the depreciation of the KRW compared to such major currencies as the US dollar and the Japanese yen. In line with the increase in visitors, the y-t-d August figure for international tourism receipts increased by 32.4% over the same period in 2011.
Major Tourism Source Markets
Japan was ranked the top international source market for Korea in 2011, accounting for 33.6% of total inbound visitors, followed by mainland China (22.7%) and the USA (6.8%).

The majority of international visitors to Korea come from Japan and mainland China, accounting for 56.3% of the total. It is also worth noting that eight of the top 10 source markets are Asian countries, with demand from these eight countries accounting for 78.2% of total international visitor arrivals in 2011.

Of the top 10 source markets, five countries, namely mainland China, the Philippines, Thailand, Hong Kong and Malaysia, showed double-digit growth in 2011 compared to the previous year.

Accommodation Demand
Of total hotel demand reported by the KHA, international visitors accounted for 75.6% in Seoul and 46.4% in Korea overall in 2011. According to the KTO, about 80% of international tourists to Korea visit Seoul. Accommodation demand from Korean residents is relatively small as most major industries are located and about half of the country's population resides in the greater Seoul metropolitan area, not only Seoul, but also Incheon Metropolitan city and Gyeonggi-do Province nearby, and as other major cities are within one-day trip distance from Seoul. Compared to Japan and Tokyo in particular, where domestic consumers accounted for about 95% and 85% of the total accommodation demand in 2011 respectively, it is noteworthy that Seoul's hotel industry relies heavily on international visitors.
Hotel Supply Trend

Hotel room supply in Seoul has increased consistently since 2005 and this trend is expected to continue in the near future.

In terms of future supply in and after 2012, we are aware of 90 hotels with 21,702 rooms that are planned for development or conversion in Seoul. If these hotels open as planned, hotel room supply in Seoul will almost double to 48,000 rooms within the next decade.

According to the KHA, the trading performance of Seoul’s hotel market (108 hotels with 20,720 rooms as of December 2011) over the past six years has been positive in terms of RevPAR from an increase both in the occupancy rates and ADR that can be attributed to rising demand and limited new supply in the market.

Existing Hotel Supply

According to the latest information provided by the KMCST, as at end-2011, there were 148 hotels with 25,160 hotel rooms in Seoul, with the average property offering 170 rooms.

Korea uses a unique system that classifies hotels in Seoul into seven types, namely super deluxe, deluxe, first class, second class, third class, non-rated and family hotels.

The super deluxe and deluxe hotel categories can be described as full-service hotels that offer such facilities as banqueting, a variety of restaurants and leisure facilities. Internationally renowned 5-6-star hotels, such as The Westin Chosun Seoul, The Shilla Seoul and Park Hyatt Seoul, are categorised in these sectors.

First-, second- and third-class hotels can be described as limited-service properties with a high proportion of room business and limited F&B options. Internationally renowned 2-4-star hotels, such as the Ibis Seoul Myeongdong and the Bestwestern New Seoul Hotel, are included in these sectors.

Non-rated hotels include new hotels currently awaiting classification, new hotels that have not yet applied for classification and hotels that have not applied for the classification that is required every three years.

Family hotels include properties with a kitchen that are designed to accommodate families. Serviced apartments, such as the Oakwood Premier Coex Center, are included in this sector.

According to the KMCST, the full-service hotel sector accounts for 64.0% of the total hotel room inventory in Seoul, with the limited-service sector accounting for 23.0% as at end-2011. The limited-service sector is expected to grow in coming years due to the relatively small number of these types of hotels in the market, the low initial investment costs and operational risks, and an expected increase in demand from Asian countries, especially mainland China.
Future Hotel Supply

The profile of the Seoul hotel market continues to evolve and the latest data point to a long-term trend towards an increase in hotel supply that is expected to continue over the next several years.

According to data from the Seoul Metropolitan Government, as of August 2012, 90 hotels, or 21,702 hotel rooms, will be added to the city from 2012 on, taking the hotel room inventory in Seoul to more than 40,000 rooms in 2016, which is an 86.3% increase over room supply in 2011. These statistics are based on the development registration applications accepted by the Seoul Metropolitan Government and there is a chance that many of these plans will be cancelled or delayed. Nevertheless, it is clear that Seoul’s hotel room inventory will rise significantly over the next a couple of years.

The increase in the number of hotels in the city can be attributed to the lack of hotel rooms catering to the increase in demand for room nights in Seoul backed by the rapid growth in international visitor arrivals. In addition, both the Seoul and the Korean governments have initiated incentive policies, such as the FAR incentive, that are major reasons for the hotel development boom in Seoul as they are attracting real estate investors and developers seeking to shift their investments to other asset classes.

With the five-year CAGR (2006-11) for hotel room supply in Seoul at 3.8% and the five-year CAGR for international visitors to Seoul at 10.6%, it is clear that growth in hotel supply has lagged behind growth in tourism demand over the past few years. As the hotel occupancy rate in Seoul in 2011 was 80.7% and since some accommodation demand was absorbed by other facilities, such as motels or non-tourist hotels and accommodation facilities outside of Seoul, the city’s hotel market is expected to enjoy strong performance for the time being, despite the planned new supply.

Based on information that has been announced, the upcoming supply of hotels is characterised by the following trends:

- The majority of the new hotels will be limited-service properties.
- Most of the hotels will be independently managed or operated under local Korean hotel brands, such as Lotte City and Shilla Stay; a limited number of hotels will be operated under international brands, including Conrad and JW Marriott.
- Many hotels in the major business districts are expected to be developed through conversion from commercial buildings and/or officetels to save on high initial construction costs.
- Several full-service hotels will be added to redevelopment projects using the FAR incentive for hotel developments, such as the Conrad Seoul in the Seoul International Finance Center.

Both demand for and supply of accommodation in Seoul are expected to continue to increase in coming years. According to the KTO, about 8.4 million foreign tourists had visited Korea as at y-t-d September 2012 and international visitor arrivals are expected to reach 10 million in 2012 as a whole. The KTO forecasts that this trend will continue until 2015, with an increase of one million visitors each year. The Korean government also announced that it will continue campaigns and/or promotional activities in order to achieve 20 million visitors by 2020, the KMCST’s target for annual inbound tourist numbers to the country.

It is to be noted that Korean won appreciation in the future may cause a decrease of inbound visitation to Seoul, which makes a negative impact on the Seoul accommodation market if the planned hotels are continuously supplied to the market.
Hotel Market Performance

The latest KHA statistics show the following trends in the performance of the Seoul hotel market:

- Since 2006, the occupancy rate has increased consistently, reaching 80.7% in 2011, due mainly to the rise in leisure demand from Asian countries and the growth in the number of international MICE events held in the city.
- ADR growth since 2007 can be attributed to the favourable exchange rate between the KRW and other currencies, and the limited room inventory in Seoul.
- Consequently, RevPAR has also grown since 2006.

Occupancy in the Seoul hotel market typically peaks during October and November, as shown in the graph below. January, February and December are shoulder months.

![Figure 10: Seoul Hotel Market Performance](image)

![Figure 11: Seasonality of Seoul Hotels' Monthly Occupancy Rate](image)
Hotel Investment Market

**Major Hotel Investors**
With only a couple owned by foreign investors, most hotels in Seoul are owned by domestic investors and independently operated under local brands.

Domestic hotel companies that are subsidiaries of major Korean corporations use their hotel businesses to strengthen their primary firm’s corporate brand image. They also use the hotel facilities for the primary firm’s accommodation and/or MICE event needs, and synergise the hotel business with their other businesses, such as wineries/importers, restaurants, duty free shops, etc.

Of the domestic hotel companies with their own brands, Shilla and Lotte are outstanding in their portfolio expansion with the new limited-service hotel brands Shilla Stay and Lotte City. It has been announced that Shilla will add 30 hotels in Korea by 2020 and Lotte will operate 40 more hotels by 2018 within and outside of Korea. These two companies, which own their existing hotels, have expanded their hotel portfolio aggressively with third-party real estate owners.

Hotels are becoming one of the most attractive sectors for real estate investors and developers in Seoul due to the decreasing investment return in other real estate sectors, the rising demand for accommodation in the city, the relaxation of government restrictions covering hotel development or/and conversion, and the possibility of the pro-rata sale of hotel rooms.

The following are the emerging hotel investor categories that are supporting the hotel development boom in Seoul:

- Real Estate Funds, or REITs, seeking to diversify their real estate portfolios.
- Real estate developers seeking to add hotels to their mixed-use complexes using the current FAR incentive offered by the Korean government.
- Companies that would like to capitalise on their main businesses and earn income from the hotel business, such as travel agencies.
- Real estate owners wanting to increase their returns on investment by converting existing buildings into hotels or by developing hotels using a higher FAR than other types of buildings.

ML (Master Lease) structure and rent structure, and FF&E (Furniture, Fixtures, & Equipment) investments will be key negotiation items between lessee and a lessor. Real estate owners that are familiar with office buildings and would like to minimize operational risks prefer fixed rents only, while hotel operators prefer variable rents based on the monthly net cash flow according to seasonality.

**Recent Transactions in the Hotel Market**
Due to increasing land prices in the city and high initial costs, the hotel business has not been considered profitable enough to pay rents or cover initial investment costs. Also, because most hotels in Seoul have historically been a unit of a family business and/or a mark of prestige for major Korean conglomerates, they have not been considered an investment option that is expected to offer capital gains through transactions until recently. Indeed, most hotel transactions that have been reported were through auctions resulting from the bankruptcies of previous owners. Since 2006, seven transactions of hotels and a serviced apartment have been reported. For the past five years, ownership of the Banyan Tree Club & Spa Seoul (formerly the Tower Hotel) and the Ramada Hotel Dongdaemun (formerly the Gukdong Star Tower) have each changed hands twice.

The Seoul hotel investment market since 2006 can be summarised as follows:

- All hotels are located in or near the city's major business districts.
- Major buyers are Korean investors.
- Many buyers are long-term investors that are seeking to expand their businesses into the hotel industry or to expand their hotel portfolios.
- The Nomura RIFA increased hotel's asset value by approximately KRW 14 billion by converting existing officetel building into a limited-service hotel during their four-year holding period.

Other than the hotel transactions noted in the table below, it has been announced that a couple of office or officetel buildings were bought by investors seeking to convert the properties into hotels. Most of these properties are located in the Seoul CBD and will become limited-service hotels. The latest transaction was in August 2012 when the owner of The Acasia Hotel bought the Rinnai office building in Donggyeodong (Seoul CBD) for KRW 50.5 billion in order to convert it into a limited-service hotel.
Major Lodging Transactions since 2006 (publicly announced transactions only)

<table>
<thead>
<tr>
<th>Property Name</th>
<th>District</th>
<th>Year</th>
<th>No. of Rooms</th>
<th>Seller’s Name</th>
<th>Buyer’s Name</th>
<th>Purchase Price (KRW million)</th>
<th>Price Per Room (KRW million)</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel La Casa (formerly New Samwha Hotel)</td>
<td>Gangnam-gu (GBD)</td>
<td>2006</td>
<td>60</td>
<td>N/A</td>
<td>Korean Furniture Retail Company</td>
<td>20,000</td>
<td>333</td>
<td>Purchase price is for 51% share of the company which owns and operates the property.</td>
</tr>
<tr>
<td>Tower Hotel</td>
<td>Jung-gu (Seoul CBD)</td>
<td>2007</td>
<td>218</td>
<td>Korean Hotel Operator</td>
<td>Korean Developer</td>
<td>120,000</td>
<td>550</td>
<td>Purchase price is for 51% share of the company which owns and operates the property.</td>
</tr>
<tr>
<td>Lotte City Hotel Mapo</td>
<td>Mapo-gu</td>
<td>2009</td>
<td>284</td>
<td>Korean Developer</td>
<td>Korean Hotel Operator</td>
<td>102,300</td>
<td>360</td>
<td>Purchase price is for 51% share of the company which owns and operates the property.</td>
</tr>
<tr>
<td>IP Boutique Hotel (formerly Itaewon Hotel)</td>
<td>Jung-gu (Seoul CBD)</td>
<td>2009</td>
<td>133</td>
<td>N/A</td>
<td>Korean Hotel Operator</td>
<td>N/A</td>
<td>N/A</td>
<td>Purchase price is for 51% share of the company which owns and operates the property.</td>
</tr>
<tr>
<td>Marriott Executive Apartment Seoul</td>
<td>Yongdeungpo-gu (YBD)</td>
<td>2010</td>
<td>103</td>
<td>Japanese Real Estate Company</td>
<td>Korean Capital Lease Company</td>
<td>55,600</td>
<td>N/A</td>
<td>Purchase price is for 51% share of the company which owns and operates the property.</td>
</tr>
<tr>
<td>Ramada Hotel Dongdaemun (after conversion)</td>
<td>Jung-gu (Seoul CBD)</td>
<td>2012</td>
<td>154</td>
<td>Japanese Real Estate Fund</td>
<td>Korean Real Estate Company</td>
<td>36,700</td>
<td>238</td>
<td>Nomura RIFA bought the property in 2008 at KRW 22.9 billion and converted this officetel building to a hotel in 2011.</td>
</tr>
<tr>
<td>Banyan Tree Club &amp; Spa Seoul (formerly Tower Hotel)</td>
<td>Jung-gu (Seoul CBD)</td>
<td>2012</td>
<td>49</td>
<td>Korean Developer</td>
<td>Korean Conglomerate</td>
<td>163,500</td>
<td>3,337</td>
<td>Purchase price is for 51% share of the company which owns and operates the property.</td>
</tr>
</tbody>
</table>

Room numbers are as of December 2011, except for the Hotel La Casa and the Tower Hotel whose room numbers as of 2006 are used.

Source: Jones Lang LaSalle Hotels based on publicly available information.
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